1999 SOCIAL SECURITY TRUSTEES' REPORT

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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CONTENTS

1999 SOCIAL SECURITY TRUSTEES' REPORT

THURSDAY, APRIL 15, 1999

House of Representatives,
Committee on Ways and Means,
Subcommittee on Social Security,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10 a.m., in room B–318, Rayburn House Office Building, Hon. E. Clay Shaw, Jr. (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225–9263
April 8, 1999
No. SS–6

Shaw Announces Hearing on 1999 Social Security Trustees' Report

Congressman E. Clay Shaw, Jr., (R–FL), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to examine the findings of the recently released 1999 Annual Report of the Board of trustees on the financial status of the Federal Old-Age and Survivors Insurance (OASI) and the Federal Disability Insurance (DI) Trust Funds. The hearing will take place on Thursday, April 15, 1999, in room B–318 Rayburn House Office Building, beginning at 10 a.m.

Oral testimony at this hearing will be from invited witnesses only. Invited witnesses will include the Social Security Public trustees. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

On March 30, the Social Security Board of trustees released its 1999 Annual Report on the financial status of the trust funds. The report's projections regarding the Old Age, Survivors and Disability Insurance (OASDI) Trust Funds are slightly improved from those reported in 1998. For example, spending out of the trust funds is projected to exceed tax income in the year 2014, and the trust funds will be depleted by the year 2034. In last year's report, those dates were 2013 and 2032, respectively.

As in prior years, however, the trustees concluded that the OASDI program is not "in close actuarial balance" over the next 75 years, the traditional measure for the financial soundness of the system. Also as in prior years, the trustees once again call for action to reform the Social Security program: "It is important to address the financing of both the OASI and DI programs soon to allow time for phasing in any necessary changes and for workers to adjust their retirement plans to take account of those changes."

In announcing the hearing, Chairman Shaw stated: "Once again, the Trustees' Report reminds us that the Social Security reform clock is ticking. The trustees continue to call for reform, and no one should take the slight improvement noted in this year's report as an excuse for delay."

FOCUS OF THE HEARING:

The Subcommittee will examine the findings of the 1999 Annual Report of the Board of trustees on the financial status of the Social Security Trust Funds.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the *close of business*, Thursday, April 29, 1999, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Social Security office, room B–316 Rayburn House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways_means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman SHAW. Good morning.

By now, many Americans are familiar—in fact, I think you have to live on the Moon not to be familiar—with how Social Security works, and why reforms are needed.

Today, 44 million Americans—1 in 6—depend on Social Security Retirement, Disability, or Survivor Benefits. But because Americans are having fewer children, living longer, and retiring sooner, Social Security's financing system faces trouble ahead.

Each year's benefits are paid for by that year's workers, so as our society ages, there will be more retirees supported by fewer workers.

That will place Social Security's financing system under increasing strain as the years go by.

As Social Security's Trustees told us in their most recent annual report, this problem will become acute after 2014 when Social Security begins to spend more on benefits than it takes in through taxes.

If we want to keep the budget balanced and pay all the benefits seniors are promised, other government spending will have to fall or taxes will have to be raised.

By no later than 2034, Social Security benefits will have to be cut or taxes increased, but not just for retirees, but for their children and their grandchildren as well.

That is if we fail to act. Some see the latest Trustees' Report as a reason to delay. Our problems are remote, they say, as much as 35 years away.

But that assumes that a good solution can be reached later when the choices will be much more painful and much more expensive.

You can call me a skeptic, but I think that will be incredibly difficult, especially if reform is delayed until the crisis is actually upon us. By then, no good options will be available.

The good news is that once again, the Trustees' Report has served as a call to action for reasonable and ultimately necessary steps to preserve and strengthen our Nation's Social Security system.

I am pleased that we have Social Security public Trustees with us to review their report and its implications, and we certainly look forward to your testimony.

Mr. Matsui.

Mr. MATSUI. Mr. Chairman, I think that in the interest of time, I'll just submit my written statement.

Thank you.

[The prepared statement follows:]

Opening Statement of Hon. Robert T. Matsui, a Representative in Congress from the State of California

Thank you, Mr. Chairman. I want to thank our witnesses for testifying today on the Social Security program's annual report released two weeks ago by the Social Security Board of Trustees. Today we will hear from the two public members of the Board of Trustees, Marilyn Moon and Stephen Kellison, whose role on the Board is to increase public confidence in the integrity of the Trust Funds. I look forward to hearing their assessments of Social Security's financial status and their views on proposals to restructure the program.

Although the 1999 Trustees Report shows that Social Security is out of actuarial balance over the next 75 years, it nonetheless brings us better news than any other Trustees Report in the past six years. The 1999 Report projects a long-range financing shortfall equal to 2.07 percent of taxable payroll and estimates that the Social Security Trust Funds will be exhausted in 2034, more than three decades from now. This is the smallest actuarial deficit and the latest projected date of Trust Fund exhaustion since the 1993 Trustees Report.

Of course, this is encouraging news, but we must continue to be vigilant in addressing the long-term challenges confronting Social Security. We should take advantage of the projected budget surpluses and robust economy to strengthen Social Security and protect the retirement income security of all Americans for the 21st century. And I know we can do it if we work together.

The 1999 Trustees Report makes it abundantly clear that, while the challenges Social Security faces are significant, they are manageable. Consequently, radically

restructuring Social Security by replacing part or all of the progressive, guaranteed, life-long benefits it provides with individual accounts would greatly endanger the income security of future retirees. Individual accounts would subject the most dependable element of workers' retirement income to greater risk and would impose the burden of enormous transition and administrative costs on our government and our working families.

The 1999 Trustees Report also highlights the critical importance of sustained economic growth in meeting our obligations to future retirees. According to the trustees, better-than-expected short-term economic growth, combined with a reduction in projected rates of unemployment over the long-term, were responsible for nearly half of the improvement in the program's financial status. We have learned that what counts the most in determining Social Security's long-term financial status is not simply the number of Baby Boomers or their projected life expectancies, but the size of the economy during their retirement and the resources available to meet their needs once they are out of the workforce.

The most direct way for the federal government to promote economic growth is to increase national saving by reducing the amount of debt held by the public. We know that national saving rises by one dollar for every dollar of public debt that is retired. In contrast, for every dollar dedicated to individual accounts, national saving would rise less than a dollar, since people would be likely to reduce other forms of saving or borrow more in response to the accounts.

The President's plan makes great strides in reducing the amount of debt held by the public. Under his plan, budget surpluses would be used to reduce the amount of debt held by the public for sustained period of time. In fact, the amount of debt held by the public would ultimately reach its lowest level since World War I. While the reform package upon which we ultimately agree may differ in some respects from the President's plan, its impact on national saving must be the same if we are truly to strengthen Social Security for the 21st century.

Thank you, Mr. Chairman. And thank you again to our witnesses for being here. I look forward to hearing your testimony.

Chairman SHAW. Thank you.

Our panel this morning, and it's our only panel, is composed of Stephen Kellison, who is a Trustee of the Social Security Board of Trustees; and Dr. Marilyn Moon, who is a Trustee of the Social Security Board of Trustees.

Mr. Kellison.

JOINT STATEMENT OF STEPHEN G. KELLISON AND MARILYN MOON, PUBLIC TRUSTEES, SOCIAL SECURITY AND MEDICARE BOARD OF TRUSTEES

Mr. KELLISON. Thank you, Mr. Chairman. It is an honor and privilege for Dr. Moon and myself to be with you today to discuss the 1999 Trustees' Reports and some of the issues that involve our activities surrounding those reports.

We have been public Trustees since 1995. This is a part-time statutory position that involves confirmation by the Senate, and we are privileged to serve in this role as the public reviewer of the process by which the Trustees' Reports are assembled.

The experience under the Social Security System depends on a lot of variables as they develop. And these break down into two broad categories, the first being economic experience; and the second being demographic factors.

In the economic area, we have assumptions that need to be made on a variety of things—gross domestic product, unemployment rates, wage growth, inflation, CPI, consumer product index, rates, productivity increases, interest rates, and the list just goes on and on.

On the demographic side, we similarly have some very major factors. We have life expectancies to look at, fertility rates, disability rates that are key in the Disability Insurance Program, immigration rates, and others.

This array of economic and demographic factors have to come together in a very complex methodology that leads to the results that you see in the Trustees' Reports.

In this process, there's a very large amount of very good work that is done within the Social Security Administration on this program and similarly within the Health Care Financing Administration on the Medicare Programs. I would like to commend the work of the actuaries in those two governmental agencies that do a tremendous amount of the detail work that lies behind these reports.

This is very high-quality professional work. I'm an actuary by profession, and I think this is an outstanding group of people and the government is very fortunate to have this quality of staff preparing the work that goes into these reports.

The assumption-setting process is probably one of the key roles that the public Trustees participate in, because one of our charges is to assure the public and the Congress and others of the integrity of these assumptions, and that they are truly the best estimates of what expected experience under these programs may be.

This year, Dr. Moon and I sponsored a series of review meetings with leading economists on the economic assumptions. There were several such meetings during the summer, probably the most extensive review of the economic assumptions we have conducted in the 4 years that we've been in this position, and we feel very comfortable at the conclusion of that process, that the assumptions that are in these reports are honest, fair assessments, based on the best information we have received from a lot of individuals, both within government and outside government.

So, we do have, I think, a clean bill of health to give in that regard from our public role in terms of the quality and integrity of the assumptions in this process.

The 1998 results of the program were good. The financial condition of both the OASI, the Old Age Survivors Insurance Program, and the DI, or Disability Insurance Program, improved during 1998.

In terms of key dates, as the Chairman has reported, the year 2014 is the first year where tax revenue begins to fall short of paying the benefits. That's an extension of about 1 year from last year's report.

The next key year is 2022, when the tax revenue plus interest falls short, and then the final year is 2034 when the combined OASDI Trust Fund is exhausted.

This year of exhaustion is an extension of about 2 years over the 1998 report.

In terms of the long-range actuarial deficit measurement, which is expressed as a percentage of taxable payroll, the OASDI long-term actuarial deficit declined from 2.19 percent of payroll to 2.07 percent, a decline of 0.12 percent, which is a significant decline.

This is the second straight year of improvement, which is very welcome news, following many years of the trend going in the other direction.

These results were driven largely by the strong performance of the economy during the past year—high rates of employment, low inflation rates, and strong wage growth.

In terms of the Disability Insurance Program, in particular, there were lower rates of disability incidence than in years past when the economy may not have been as strong.

One issue that deserves special mention in the assumptions this year is that the effects of the 0.2 percent adjustment in CPI, consumer product index, made by the Bureau of Labor Statistics in April 1998, was included in this year's report. It came in too late to be included in the 1998 report 1 year ago. That was fully reflected in this report.

In terms of the formal tests of trust fund solvency that the program has experienced, the program does satisfy the short-range test. The OASI and DI funds are above 100 percent of the following year's payments, and that does persist over the 10-year period.

However, the program does fail the long-range test of close actuarial balance. The maximum tolerance there is 5 percent, and the long-term actuarial deficit is much larger than that.

In making these projections, there is a significant amount of uncertainty. We talked about that in our report this year. As part of the measures of uncertainty, we do look at some alternative scenarios, called alternatives I and III, to try to capture a range of possible outcomes.

Despite the uncertainty and the difficulty of trying to make projections over a 75-year period, we are strongly committed to the desirability of continuing to do that. The 75-year period has been part of the process for a long time, and we think it should continue.

This is a period of time that basically encompasses a working lifetime and a period of retirement for a typical person. It is a period of time that is necessary to capture the full effect of demographic factors like the baby boom, and it does impose a discipline on our process of recognizing that this is a long-term program that needs frequent review as it's going along to continue to refine estimates of the financial condition of the system.

In terms of the dynamics of the system, what is driving the pattern of costs is essentially a demographic issue. It was the baby boom generation followed by the baby bust generation, low fertility rates that have been fairly stable now for close to 25 years, and increasing life expectancies, people living longer in retirement.

This is what is driving the long-term financial results of the program.

These factors are pretty well locked into place. They're not going to change dramatically in a short period of time.

Economic factors are also important in the sense that a richer economy that's more productive perhaps can afford a more rich social insurance program; a poorer economy that's leaner, probably cannot afford as much of one.

But the demographic effects will be in there, regardless of the performance of the economy.

The effect is that today, Social Security is running surpluses because the FICA taxes bring in more revenue than the payments. Once the baby boom generation retires, costs escalate dramatically until revenues fall short of the benefits, and then the cost rates ul-

timately do stabilize, but they stabilize at a much higher level than they are at today.

Another way to look at this is in terms of the worker/beneficiary ratio. Today there are 3.4 workers per beneficiary.

At the end of the 75-year projection period, that will fall to 1.8 workers per beneficiary.

At the end of the 75-year period, the tax rates will pay about two-thirds of the cost of the program.

In terms of percentages of gross domestic product as another measure of the magnitude of the system today, Social Security, OASDI, represents about 4.5 percent of the gross domestic product.

At the end of the 75-year period, this will rise to a little over 7 percent of the gross domestic product, so that gives you some magnitude. It's about a 58-percent increase in the magnitude of the program in terms of the portion of the total economy that it represents.

Another phenomenon of the current law and the financing program is that because cost rates are less than the tax rates today and higher later on, you do get a significant trust fund buildup, followed by a significant trust fund drawdown.

Today, the combined OASDI Trust Fund is about 190 percent of 1 year's payment, well in excess of the 100 percent that we look at for short-term solvency. This will increase to about 360 percent in the year 2013.

At that point, it declines very precipitously, going to zero in the year 2034, so you do have this phenomenon of a huge trust fund built up, followed by a very significant drawdown.

This has budgetary and macroeconomic effects. As we know, the effect today is that Social Security surpluses mask deficits in the rest of the budget.

This will all reverse when the trend goes the other direction, and when Social Security would be running shortfalls, and that will exacerbate any deficits that exist elsewhere.

At this point, I think I've run out of time by quite a bit. I'd like to close with a summary and then turn it over to Dr. Moon who will talk about where we might go from here in terms of Social Security.

I think my recap would be that 1998 was a very favorable year. However, the long-term picture of the program is relatively unchanged. The demographic issue is still there.

There was modest improvement, but the basic picture is unchanged over the last several years, really.

I think as we continue to monitor this system and work on the annual reports, that it's important we make the changes in the assumptions incrementally as experience really develops over a period of time.

There is a temptation when times are good as they are now, to get euphoric about how well things may work out; equally, there are temptations when the economy is in a recession to think it's gloom and doom forever.

These extremes in perspective probably are not the way to run a 75-year program, and I think the changes that we look at should be made incrementally, and I think this report was done in that spirit.

At this point, I would turn it over to Dr. Moon and entertain questions at the end.

Chairman SHAW. Thank you.

Dr. Moon.

Ms. MOON. Thank you. Like Steve, I'm very privileged to be here. I appreciate the chance to address the Subcommittee.

As one of the two public Trustees, I am not the actuary, so I have learned a lot in the last 4 years about how these estimates are done, and I've also been impressed at how carefully the review process goes on and how difficult it is to look in your crystal ball 75 years into the future. These are not easy things to look forward to.

Nonetheless, I think that we feel these trust fund reports provide a good indication of what we could likely expect, and provide essentially an early warning device for changes that are going to be needed in the program.

And it is in that spirit, rather than taking all of the numbers literally, that I think we move forward. I would reiterate what Mr. Kellison said: Despite the good news that we are discussing today, there is still an urgency to make changes in this program because we like to think of this program as a very long-term program that you want to keep secure, and you want to assure younger people that it will still be there in the future.

As a consequence, I think that vigilance is something that people should take very seriously.

As we note in our testimony, payroll taxes for OASI, which are now at 5.35 percent each for employers and employees, would have to be raised, if you did it only through taxes, which we are not proposing, but as an illustration, by 16 percent if we made those changes today, to 6.2 percent of payroll.

If we wait until the year 2025, we would have to raise those tax rates to a little over 7 percent each. That means not only a much larger increase in those burdens, but it also means a shifting of the burdens away from this current generation of baby boomers who are still working and contributing to the system to future generations as well.

We also note in the testimony that we believe there are many ways to solve the problems, and it is not our role as public Trustees to advocate one particular approach, but rather to be here to indicate what we think will be the future for the trust funds with no action, and then, of course, once action is taken, to evaluate those in another report later on.

We also note, however, that we do not see these problems, serious as they are, as ones that mean inherently you must do a massive structural change. We do have a choice still at this point in time of whether or not you have major structural changes or more modest, incremental changes.

Those are choices that fortunately are still before people like your Subcommittee, to make those decisions, rather than being forced into a particular decision.

We also note that this year's good news reminds us that we should not just use a few years, as Steve Kellison also said, of good news or bad news to make policy. The disability changes that occurred, for example, in the early nineties caused a lot of consterna-

tion and concern because it looked as though disability was going to rise forever, and it suddenly stopped with no particular understanding or reasoning as to why all those changes had occurred.

So, if we had locked in a lot of changes at that point in time, we might now be talking about undoing them.

Similarly, good news and bad news for a few years does not change the outlook of the picture, although it is interesting to see how even small changes in the economy can sometimes change the projections.

We are, therefore, cognizant of how important it is to make changes in the assumptions very slowly over time, recognizing both the uncertainty and the need not to unduly alarm or reassure people by short-term changes.

Finally, the other important thing that I think we take from this is that seeking 75-year fixes represents an ambitious undertaking. As we sit in our position, we're concerned that sometimes the emphasis on just a 75-year fix can lead us in the wrong directions.

This can be, perhaps, either in terms of seeking only an all-or-nothing sort of change, only overarching changes and no incremental changes, or in tailoring those changes that do take place, only to achieving 75-year numbers. But one of the things we certainly have become cognizant of over time is how difficult it is to target 75 years into the future with exactitude.

So, our testimony essentially urges you to make changes when you feel you can and there is consensus. Even if they don't solve the 75-year problem, perhaps that may be one way of adding some urgency and discussion that otherwise is lacking in some of the situations that we're facing in terms of trying to find consensus.

In conclusion, we would add that based on our experience as Trustees over the last 4 years, it is clear that Social Security cannot and should not be insulated from all the other things that take place in society. Social Security will need to change and be adaptive.

But it is also important that we need to think about this program in the very long term. That's how it was created, and we are strong believers in that's how it should continue.

Thank you very much.

[The joint statement follows:]

Joint Statement of Stephen G. Kellison and Marilyn Moon, Public Trustees, Social Security and Medicare Board of Trustees

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

It is our privilege to be here today to testify regarding the financial status of the Social Security Trust Funds as shown in the 1999 Annual Report of the Board of Trustees of those funds. As you know, the Public Trustees are part-time officials appointed by the President and confirmed by the Senate to represent the public interest in this important process of public accountability. In our normal activities, Mr. Kellison is an actuary and consultant and Ms. Moon is an economist and researcher, both with extensive public and private experience in Social Security and Medicare.

As Public Trustees, our primary activities are directed at assuring that the Annual Trust Fund Reports fully and fairly present the current and projected financial condition of the trust funds. To this end, we work closely with the Offices of the Actuary in the Social Security and the Health Care Financing Administrations to ensure that all relevant information is considered in the development of assumptions and methods used to project the financing of these vital programs. Mr. Chairman, we would note for the record what we are sure you and this committee know well: it is an extraordinarily complex task to make financing projections for these programs for the next 75 years. It is only through the high professionalism and dec-

ades of experience of the Social Security and Medicare actuaries that such projections are possible. But it is critical to remember always that these projections ultimately are only estimates and must necessarily reflect the uncertainties of the future.

Thus, the projections in the trustees reports are most useful if understood as a guide to a plausible range of future results. And, as this hearing illustrates, the reports serve as an early warning system that allows us the opportunity to make changes in a timely and responsible manner.

THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND

In the 1999 report, the Old-Age and Survivors Insurance (OASI) Trust Fund, which pays Social Security retirement and survivors benefits, shows a positive balance at the end of 1998 of $681.6 billion with a net increase in that year of $92.5 billion. The fund's assets now equal 2 years of projected benefit costs. The OASI fund has been taking in more in tax revenues than it has been spending for a number of years and is projected to continue in that mode for 15 years. As the baby boom generation begins to reach age 65 after 2010, however, OASI benefit costs each year will increase rapidly and, beginning in 2015, will exceed annual tax income.

However, the accumulated assets of the OASI fund, interest on those assets and tax revenues are projected to cover benefit outlays until 2036, two years longer than projected in the 1998 trustees report. Although the assets of the OASI fund would be exhausted at that time, tax income provided under current law would equal nearly three-quarters of full benefit costs in 2036. By 2073, however, the portion of benefits that tax income would cover is projected to decline to about two-thirds. Over the full 75-year period, the OASI fund shows a deficit of 1.70 percent of payroll, which is almost 13 percent of the projected summarized 75-year cost of the OASI program.

THE DISABILITY INSURANCE TRUST FUND

Turning to the Disability Insurance (DI) Trust Fund, it also showed a net increase in 1998 of $15.4 billion and ended that year with a positive balance of $80.8 billion. As this committee is well aware, disability costs are more difficult to project than are retirement and survivors benefits. Historically, the Social Security Disability Insurance program has experienced periods of growth and decline for which causes cannot be established with certainty. In the early 1990's the number of workers applying for disability benefits increased rapidly, and there was great uncertainty whether this was a temporary or a long-term phenomenon. Actual experience since 1993 shows that applications for disability insurance benefits levelled off in 1994 and have actually declined slightly each subsequent year despite the fact that more people are moving into the prime ages for disabilities. It seem likely that the tight labor market has contributed to the lack of growth in disability insurance applications. The total number of disabled workers receiving benefits has continued to increase, however, because more people have come onto the rolls each year than have left.

The disability program has experienced significant and not fully explained fluctuations over the last two decades. The trustees therefore recommend that the program be monitored closely in coming years. The 1999 Trustees Report intermediate projections show that income to the DI fund will exceed expenditures through 2005, but that full DI benefits can be paid until the fund's assets are exhausted in 2020. Over the 75-year projection period, the DI fund shows a deficit of 0.36 percent of payroll, or about 16 percent of the program's projected 75-year cost.

If the DI and OASI trust fund projections are combined, the exhaustion date for the combined funds is 2034, 14 years later than for the DI fund and 2 years sooner than for OASI. On a combined basis, expenditures first exceed tax revenues in 2014. From 2015 through 2021 interest income will be needed to supplement current tax income to meet costs, and in 2022 through 2034, current tax income, interest income plus a portion of the trust fund assets will be needed to pay benefits. Considered together, the OASI and DI programs have a projected long-term deficit of 2.07 percent of payroll, which represents an decrease in the deficit of 0.12 compared to the 1998 projection.

The primary reasons for the reduction in the projected actuarial deficit in the 1999 trustees report are the continued good economic experience in 1998 and an improvement in the projected economic performance in the future. The major reason for the improved outlook was taking account of the announcement by the Bureau of Labor Statistics in 1998 that the measured cost-of-living will be reduced by 0.2 percent per year in 1999 and later due to the Bureau making changes in the meas-

urement methodology it uses. We met with a variety of economic experts last year to perform a comprehensive review, particularly in light of the BLS change, of the economic assumptions used in this report. We were gratified that there was wide agreement on the range for the assumptions, but with full recognition of the uncertainty involved.

Is Legislative Action Needed?

The Board of Trustees has established both short-term (10 year) and long-term (75 year) tests of financial adequacy for the trust funds. Over the short range, if a fund has sufficient assets on hand at the beginning of each year to pay projected benefits for that year—what is termed a trust fund ratio of 100 percent—we considered its financing adequate. Both the OASI and DI trust funds are expected to maintain trust fund ratios above 100 percent throughout the next 10 years and thus meet the trustees short-term financing test. You will recall that the DI fund failed this short-term test early in this decade and the trustees wrote to the Congress, as they are required to do, to recommend legislative action, which was taken in 1994. Then, the Hospital Insurance part of Medicare failed the short-term test for several years until the Balanced Budget Act of 1997 was enacted. Based on the 1999 trustees reports, however, the OASI and DI, as well as HI, trust funds satisfy the trustees' short-term financing test.

Over the long range, the trustees' test of financial adequacy is that a trust fund projected actuarial costs be no more than 5 percent larger than projected income in the 75th year, or a proportionally smaller variance for shorter periods. Neither the OASI nor the DI trust fund meets this test, referred to as "close actuarial balance." Thus, the trustees recommend that legislative action be taken to bring these trust funds back into close actuarial balance and stress that it is important to address the long-range financing shortfalls in the OASI and DI funds soon in order to allow time for phasing in any necessary changes and for workers to adjust their retirement plans to take account of those changes. We would also note that there has been an alarming erosion of public confidence in the Social Security program over the past few years, particularly among younger generations. Early attention to Social Security's financing problems is important to restoring public confidence in the program.

Another important consideration regarding the timing of action on Social Security financing is that the sooner changes are enacted the more broadly can the burden of closing the financing deficit be distributed across different age groups. For example, if it were decided to raise payroll taxes now to eliminate the OASI projected deficit, employers and employees each would have to pay about 16 percent more in all future years (i.e., to about 6.2 percent rather than the 5.35 percent for 1999). If the change were not effective until 2010, the rate would have to be increased to 6.42 percent, and if delayed until 2025, the tax rate would have to be increased by almost one-third to 7.02 percent. Other types of changes would have similar increases in size if their effective dates were significantly delayed. Further, the longer we delay in making changes in either taxes or benefits, the more the burden of those changes will be concentrated on future workers and beneficiaries. Thus, while we have time to consider and plan carefully for necessary changes in Social Security, we should act as soon as a rational reform plan can be developed and support built for it.

So, in answer to the oft-asked question, "When is legislative action on Social Security financing needed?," on the basis of the 1999 trustees report projections we would respond, "The sooner the better!" But we would add that this program is too vital to every American to make hasty changes that are not fully thought out. Of course, Mr. Chairman, we recognize and appreciate that this committee has over the years exercised great diligence in assuring that changes in Social Security are as good as we can devise. We applaud the committee's efforts to investigate proposed reforms and build a record on which well-considered legislation can be based.

Is All-or-Nothing the Only Approach to OASI Financing Reform

As we have said many times, Social Security's financing deficit can be solved with OR without major structural change. Unfortunately, it appears at times that Social Security financing reform is presented as a choice between dramatic structural change or nothing. That is, those who support structural change have seemed to have an incentive to oppose any other change because it looked as though with each new trustees report the OASI and DI deficits would grow larger and the pressure for reform greater. Then, in both the 1998 and 1999 trustees reports the projected deficits under the intermediate assumptions were reduced somewhat, in considerable part due to the continued good performance of the U.S. economy. Given this

set of historical circumstances, three points regarding long-term financing reform of Social Security strike us. First, longer term change should not be driven by only a few years' experience. For example, in the early 1990s, the Social Security disability insurance rolls grew dramatically in 1991 and 1992, but then just a quickly stopped growing. Legislation based only on either of those periods would have been subject to error. Similarly, Social Security financing legislation enacted on the basis of only the poor economic performance of the U.S. economy in the 1970s would have been misdirected, just as basing legislation only on the last few years of economic experience could be misleading. The trustees, with the extraordinarily able assistance of the actuaries, have always tried to base their projections on long-run expected averages, and not on extremes in experience over short periods.

Second, aiming for a reform package that will "fix" the Social Security program's financing for as long as 75 years may be too ambitious and potentially can mislead policymaking. As the trustees note each year, the projections in their reports are not intended as predictions but rather as indicators of the expected trend and likely range of future income and outgo under a variety of plausible economic and demographic conditions. In recognition of the fact that we cannot predict the future perfectly, the trustees' long-range test of financial adequacy calls, as we described, for projected costs income and costs not to diverge by more than 5 percent. Implicit in this test is an allowance for change in the actuarial balance in each new annual trustees report without ringing alarm bells because the program's 75-year projected actuarial income and costs do not perfectly balance. Thus, we believe any Social Security financing legislation should evaluate changes on their merits, and not allow a 75-year point estimate to influence the type or degree of change.

Third, we would hope that when programmatic changes arise that make sense and can obtain substantial support, legislative action will not be delayed until one overarching reform package is developed. For example, a number of changes, such improved benefits for widows(ers), were contained in at least two of the reform plans offered by the 1996 Social Security Advisory Council, but the strong sense of need for changes in such areas is lost in the standstill over finding a comprehensive financing plan. Further, the danger of making policy changes in the context of seeking a specific level of savings or achieving perfect 75-year actuarial balance is that the policy change may be altered to fit the numbers rather than designing it on the basis of what makes the best sense. For example, the scheduled increase in the retirement age—2 months per year for 6 year, no change for 11 years, and then 2 months per year for 6 more years—was an artifact of achieving the right level of savings rather than deciding the best way to phase in changes in the retirement age without creating unnecessary "notch" effects.

Conclusion

Based on our experience as trustees over just the last 4 years, it is overwhelmingly clear that Social Security cannot be insulated from social and economic change in our country in the future, just as it has not been in the past. The strength of the Social Security program has been that it can adapt as our national circumstances change. It is the acceptance of the necessity for change by all of us as individuals that is most difficult. This can be eased only by having the information we need to be able to understand why change is necessary and in which direction it should take us. This committee serves a crucial role in developing the necessary information for Social Security policy development, and we welcome the opportunity to participate in this hearing to discuss the dimensions of Social Security's financing problem.

We have attached the four-page "Message From the Public Trustees" that is included in the *Summary of the 1997 Annual Reports,* as well as our biographical information. We thank you for the opportunity to present our views and will be pleased to answer any questions.

FROM A SUMMARY OF THE 1999 ANNUAL REPORTS OF THE SOCIAL SECURITY AND MEDICARE BOARDS OF TRUSTEES, MARCH 30, 1999

A MESSAGE FROM THE PUBLIC TRUSTEES:

We are privileged to take part in the thorough and careful process by which the Annual Reports are prepared to provide this vital public accounting. Our goal as Public Trustees is to ensure the integrity of the process by which these Reports are prepared and the credibility of the information they contain. Further, although we

are of different political parties, we approach our work as Public Trustees on a bipartisan basis because this is the only way through which financial problems facing Medicare and Social Security can be solved.

1998: Strong Economic Performance Boosts the Trust Funds

Continued strong economic growth in 1998 caused income to the Social Security and Medicare trust funds to be higher than expected, strengthening the current financial condition of both programs. In addition, for Medicare the growth of benefits was lower than projected. The long-run financial outlook for both programs also has improved for the second consecutive year. The Social Security trust funds now are projected to run short of money to pay full benefits in 2034, rather than 2032 as projected last year, while the Medicare Hospital Insurance trust fund is projected to have insufficient funds in 2015, rather than 2008 as previously projected.

After many years of watching the outlook for both programs worsen without legislative action, two successive years of improvement is significant. Further, this reminds us that the demography of an increasingly older population with its resulting declining number of workers per retiree is not the only issue—that continued strong economic growth could make promised benefits more affordable in the future. We say "could" rather than "will" because we cannot prudently rely on economic growth continuing at this rate. Instead, it is essential to make the best projections possible based on the best available data and methods and to update those projections each year.

Projections Are Always Uncertain

One lesson we have come to fully appreciate is that projections are expert "guesses" about the future and not predictions of what will actually happen. Uncertainty is unavoidable because projections depend upon almost everything that happens in our society (marriage and divorce rates, birth rates, immigration rates, death rates, disability and recovery rates, retirement age patterns) and in our economy (the number of people working, their productivity and wages, inflation rates). Accurately predicting any one of these factors even for one year is difficult; projecting all of them for 75 years is mind-boggling.

Then why undertake such projections, especially for 75 years into the future? As the reports note, a 75-year period spans the working and retirement years of the vast majority of people now covered by these programs. And, the effects of demographic changes, such as the sharp increase in the birth rate after World War II that led to the "baby boom" generation, can be fully taken into account.

One way we as trustees deal with the inherent uncertainty in long range projections is each year to reexamine in light of recent experience all our assumptions about the factors that underlie Social Security and Medicare financing projections. During 1998 we met with a variety of economic experts to undertake a comprehensive review of the economic assumptions in these reports. We were gratified that outside reviewers were generally supportive of the assumptions we use. But even when modifications are needed, assumptions for a period as long as 75 years into the future should change only slowly over time. For example, two or three or even five years of poor or strong economic growth do not mean that we should assume such performance for 75 years.

Uncertainty, Politics and Reform of Social Security and Medicare

In each of our previous statements regarding the annual trustees reports, we have indicated the need for reforms in both Medicare and Social Security and the benefits of acting sooner rather than later. Like our predecessors in this job, we believe it is important to indicate that even with the uncertainty that exists in projections, changes will be needed to keep these programs on a solid financial footing. Last year an important national debate on Social Security was begun and a greater awareness of the problems facing that program was achieved. The National Bipartisan Commission on the Future of Medicare also worked over the past year to find a set of recommendations to send to the Congress for action but was unable to reach agreement on proposals for change. Thus, despite wide agreement that reforms should be made sooner rather than later, it is not at all certain that major changes in either program will be forthcoming in the near term.

Why is reaching agreement on change in these programs so difficult? Fear of change is instinctive, but it should be reassuring that Social Security and Medicare have been adjusted many times since they were enacted. And, there is no reason for us to think now that Social Security or Medicare should be frozen in place for the decades ahead. The economic and social factors that determine the financial health of Social Security and Medicare will change in the future as they have in

the past. Thus, as citizens, we have to expect and accept the need to periodically adjust eligibility, benefits and financing for these programs.

How much of the reluctance to act is due to legitimate concerns about the inherent uncertainty of the financial projections, and how much to an inability to reach political consensus on what will be hard choices, is not clear. But the Bipartisan Medicare Commission's difficulty in reaching consensus raises the issue of whether it is wise to focus on finding one overarching solution to the problems these programs face, or whether to seek instead incremental changes on which agreement might be reached.

Medicare

Medicare costs are increasing both because new, more expensive (and effective) medical technology is being developed every year and because an aging U.S. population has greater medical care needs. As the slowing of spending in response to recent legislative changes indicates, more efficient health care delivery systems can moderate Medicare's cost growth. Even with these improvements, however, the system still faces major financial shortfalls because program costs are increasing much faster than the rest of the economy. A lack of consensus on sweeping reforms should not preclude measured changes to make Medicare a more streamlined and effective program. Additional substantial legislation needs to be enacted no later than 2007, the year that HI annual expenditures are projected to again exceed annual income. Once deficits begin, the financial outlook for the HI trust fund will dramatically worsen. The extension of the trust fund exhaustion date to 2015 should be welcomed as an opportunity to take the time to evaluate what options may mitigate the financing problem but also preserve the strengths of the program.

Social Security

The long-term financing problem facing Social Security is significant but could be solved by small gradual changes IF those changes are enacted soon. The public discussion of the last year has advanced the reform debate by bringing into sharper focus the limitations and administrative difficulties of replacing a major part of Social Security with individual savings accounts. One way not discussed in recent years to deal with uncertainty and political gridlock could be to enact modest changes in benefits or eligibility that would be triggered by changes in key indicators. For example, [in some way] tying the age of eligibility to life expectancy changes, or tying benefits to the growth in wages rather than prices, would help stabilize program financing. We are not proposing such indexing: a reasoned political debate reaching consensus would be the preferred solution. But we do note that a major step in the direction of indexing was taken in 1972 when automatic cost-of-living adjustments and automatic earnings-base indexing were added to replace ad hoc legislative adjustments made haphazardly, and that these changes have come to be valued as integral parts of the program.

Conclusion

We strongly believe that these Reports serve as an early warning of the need for changes to ensure continuation of Social Security and Medicare and not as evidence of their failure to protect future generations. Working cooperatively, with informed public debate, solutions can be found to the financing problems facing America as our population ages. It is time to begin that undertaking.

Chairman SHAW. I thank you both for very fine testimony. I also would be remiss if I didn't thank you for your good work. I know that you're up for reappointment, and if that's the direction you want to go, that's the direction that is in the stars for you, and I certainly appreciate the quality of the work of both of you.

Mr. Kellison, I have just a few questions with regard to your actuarial assumptions.

Do you predict rising unemployment, recession, in and out of recession, as far as your projections are concerned, or do you assume that the economy we have today will continue?

Mr. KELLISON. We have a long-term assumption that would be less favorable than the economy today.

The economy is today, by historical standards, extremely strong. Unemployment rates are at 30-year lows, really,

The long-term unemployment rate assumption, we did bring down in the report, I think, from 6 to 5.5 percent, if I remember. This is higher than the unemployment rate currently in the economy, but certainly in terms of a historical average over longer periods of time, something we think is very commensurate with long-term experience.

So, we did improve the long-term actuarial balance on the unemployment assumptions this year, thinking there was enough evidence to bring it down, but it is still higher than is experienced in the economy at the present time.

Chairman SHAW. Your assumption assumes a level of 5.5 percent unemployment?

Mr. KELLISON. In the long range, as an average, yes.

Chairman SHAW. Life expectancy, did you assume that we may conquer cancer? There are, I tell you, medical research and technologies that are going forward at a tremendous speed, which could very well—I remember, growing up, my grandfather died in his early eighties, and we thought that was as old as you can be.

Today, when someone dies in their seventies, we say isn't it a shame, they were so young.

What are you assumptions with regard to that? I am very sensitive, in that I turn 60 on Monday, and I'm very sensitive to that.

Mr. KELLISON. Well, I'm increasingly sensitive to that myself. It's amazing how your perspective changes over time on that.

Chairman SHAW. It surely does.

Mr. KELLISON. You rightly have identified life expectancy as a key factor in the cost of the program.

That is, clearly, the length of time people live in retirement, on average, is an obvious contributor to the cost of the program.

There have been increases in life expectancy throughout this century that we've measured and looked at. There have been some oscillations in that over time, but there certainly, overall, has been significant improvement in life expectancy.

The Trustees' Reports project continued improvements in life expectancy, based on past trends. I guess that would be the best way to put that. It's broken down by gender and other factors to try to refine it, but it's essentially extrapolated off of past experience.

I would not say that we have quantified a quantum breakthrough in miraculous cures of diseases in the elderly population. It did not encompass that kind of an assumption on our best estimates.

I think in some of the alternative III, that is, the high cost estimates, there are much more significant improvements in life expectancy that were looked at to see what their effects would be.

In the Trustees' Reports there are sensitivity tests on all of the assumptions so that you can isolate each one, one by one, to get some idea as to what the effect of that change would be.

There is some information in the Trustees' Reports on that, but I would, I guess, indicate that the best estimate assumption and our central assumption is an extrapolation off of past experience; it does not assume a quantum breakthrough in life expectancy in the elderly.

Chairman SHAW. What has been the increase in life expectancy, say, over the last 20 or 25 years?

Mr. KELLISON. Since 1980, it's a little under 1 percent a year in the overall rate for males, but about 0.5 percent and decreasing for females.

Chairman SHAW. Is that what you project in the future, a continuation of 1 percent?

Mr. KELLISON. Yes, under alternative III assumptions, but closer to 0.5 under alternative II.

Chairman SHAW. OK.

Dr. Moon, what is your Ph.D. in?

Ms. MOON. Economics.

Chairman SHAW. OK.

I've got a degree in accounting, so I'll try to deal with it, and maybe we can communicate, if we talk slowly to one another.

Ms. MOON. OK.

Chairman SHAW. The structural changes that you referred to—and I think that your economics degree would certainly qualify you to discuss this particular area.

If we are not to change the benefit structure, and if we are not to increase the taxes, what are the alternatives available to us in trying to reform Social Security?

Ms. MOON. My guess is that no one has invented a way to solve the problems in the future without talking about changes in the benefits or in the——

Chairman SHAW. I'm not asking you to invent anything. I'm asking you just how other pension plans work, how other investments work, as to where does this Subcommittee turn to find how we can solve the problems of Social Security.

I'm talking about for 75 years now, because I think that is very telling. It would be, to my knowledge, one of the first times this Congress has really looked forward in trying to solve something for 75 years, instead of just dumping the problem on the future generations.

Ms. MOON. The 1996 Social Security Advisory Council, I think, pretty much defined the range of alternatives that are out there, looking at everything from incremental changes only, to more structural changes that would rely on having individuals develop private accounts or that would try to obtain some additional returns from investing the trust funds in riskier stock market activities and so forth, as one way to try and expand what the opportunities are for Social Security.

I think that pretty much is the list, if you looked at that list, that is, I think, the relevant list that you all should begin to think about.

My sense is that there is a whole range of things that could solve this problem, and you could, to some extent, take some from column A and some from column B, but I think there probably are directions that move you off on to a couple of different branches.

Chairman SHAW. Let me give you a yes or no question. If we are to hold the line on payroll taxes, not increase payroll taxes, and we are not to cut benefits, then it's correct that we do have to look at the investment structure of Social Security; is that not correct?

Ms. MOON. If that is your restriction, yes, then I think you would do that, but the caveat, I would say, is that there are costs of the other direction as well. That is that higher risks from investing privately are clearly there and will result in not necessarily then an equivalent change. There will be a different set of choices.

Chairman SHAW. OK, now, what you are telling me then is that we set that out as our model, then we are going to have to turn to the private sector in order to increase the return on our investment, but those investments do carry with them, certain risks?

Ms. MOON. That's right.

Chairman SHAW. Now, over the long run, if you have widespread investment over large areas of stocks and a mix of corporate bonds, does that reduce the risk, if you're looking over the long period of investment from historical data?

Ms. MOON. Yes, indeed, certainly expanding the range of things that you look at will reduce the risks. Whether it will reduce the risks for individuals when they have choices among those options and then they have timing issues in terms of when they retire, is another issue, as well.

Chairman SHAW. But over the long run, over the long period of time, realizing there will be fluctuations in the market and if somebody is retiring in 2014, they could have a bad year in the stock market and they could find that an individual retirement account is actually deflated.

But if you were to go over the long run, then the return on investment, the return on the taxes that are paid in for Social Security would be far greater than they are today; is that not correct?

Ms. MOON. I don't know that I would say far greater, because I think people sometimes make an incorrect assumption about the rates of return today.

The rates of return today, if you look at the rates of return from the Treasury bills themselves that are held, are reasonably high.

The rates of return that people often talk about for Social Security are a reflection of the demographic issues; that I, as an individual, paying taxes into a pay-as-you-go system, will not draw out as much as if I put that money into a private account.

But, in part, that's because my tax dollars today are going to help support today's generation, and next, when I retire, then I'm depending upon the next generation.

Some of that lower return that people sometimes point to is simply because there are going to be fewer of those workers that Steve was talking about to support me in my retirement.

Chairman SHAW. Now, this is going to be the ultimate test. I'm going to ask you an accounting question.

Ms. MOON. OK. I did take accounting.

Chairman SHAW. And I took economics, and I didn't understand it. [Laughter.]

In the existing system—and it has been made very clear, I think, by both of you that the tax dollars outside of the FICA tax are going to be necessary after 2014 in order to support our retirees. One of you made the observation that it's going to be 75 years from now that you're going to have just 1.8 workers supporting one retiree, which would be just an unbelievably horrible burden for those young workers.

I've got two grandchildren that are going to be coming into the world this year, and I just can't imagine leaving that mess to them.

But from the cash flow situation, would the result be any different as far as the cash flow with or without the trust fund?

Ms. MOON. In terms of the cash flow? I'm not sure exactly what you're asking.

Chairman SHAW. In other words, we have a system where FICA dollars are being paid into the Social Security Trust Fund. By law, those funds immediately go out of the trust fund and are invested in Treasury bills under existing law.

The President made a suggestion that we run the surplus back through the trust fund. It certainly could be argued that that money came out of the trust fund to begin with, so following his scenario, we could increase the amount of Treasury bills in the trust fund.

But if that's a great idea, then we should take that money that came out of the trust fund and run it through several more times and pile up a lot more Treasury bills.

Now, my question to you, and what I am concerned about is the tax burden on the future generations. The Trust Fund itself, would the result to the taxpayer through general revenue and through FICA tax, be any different with or without the trust fund itself?

Ms. MOON. I am a believer in the trust fund, which probably is rational since I'm a public Trustee. I believe these are promises to pay that are taken seriously, and that are an important contribution to try to ease the burden into the future.

Chairman SHAW. Right.

Ms. MOON. In that sense, I think that if what happens on a cash flow basis is the trust funds, over time, become the most important and perhaps the dominant way in which debt is held by the Federal Government——

Chairman SHAW. You're not answering my question. I understand that it is a commitment, it's a public commitment by the taxpayers, future taxpayers.

But my question is strictly asked on a cash flow basis.

Ms. MOON. But I thought you were asking whether or not it is going to make it easier in the future to pay these——

Chairman SHAW. I didn't say easier, I said, whether it would be any difference on a cash flow basis if you had or didn't have the trust funds.

Ms. MOON. Well, now you're going to catch me on some of the accounting of which I am not as skilled as you.

I believe the notion that, over time, the higher interest being paid into the trust fund by having the trust fund be larger is helpful to the system.

Chairman SHAW. And where does that interest come from?

Ms. MOON. It comes from the Federal Government.

Chairman SHAW. And where does the Federal Government get that money?

Ms. MOON. It gets it from taxes, you're absolutely right.

Chairman SHAW. The burden on the taxpayer is going to be the same, with or without a buildup of the trust fund.

It's a simple question.

Ms. MOON. The burden on the taxpayer is not necessarily—I think of the question of what other resources are used for other things. If the rest of the——

Chairman SHAW. I'm having trouble getting an answer.

Let's assume——

Ms. MOON [continuing]. The rest of the debt——

Chairman SHAW. The economists always make assumptions, so let me try to make an assumption. All things remaining equal, would the burden on the taxpayer be any different with or without the existence of the trust fund?

Ms. MOON. No, I don't believe that it would be.

Chairman SHAW. Thank you.

Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman. I appreciate the report and your testimony today. I think even though the report is somewhat more optimistic from what it was 2 years ago, it does bear out that something has to be done and something has to be done soon.

We really appreciate this. I don't think anybody, because we have an additional 2 years on the program, takes the position that we can relax a little bit and not take action.

Mr. Kellison, what I'd like to ask you is, your assumptions, CBO has certain assumptions over the next years and certainly OMB does as well in terms of massive surpluses, both in the Social Security system through the payroll tax, and obviously general fund surpluses that will build up 3 or 4 years from now and be very sizable as well.

Are your assumptions more optimistic, pessimistic, or about the same as CBO and OMB?

Mr. KELLISON. I think in the short run, 3 or 4 years, they're pretty consistent. The way we go at the assumption-setting process is to look at both the long-range and the short-range assumptions as two separate exercises, and then we try to develop a program of grading in the assumptions from the short run into the long run.

I think the short-range assumptions that we use, we try to validate against other assumptions, both within the government and outside government by private sector forecasters.

We try to make an independent judgment on our own assumptions, but we certainly do look at what others are projecting, and we look at the ones that CBO and others within government do.

My sense is that in the short-range period, they're not exactly identical, but they're quite close.

Mr. MATSUI. What about the long-term assumptions?

Mr. KELLISON. The long-term assumptions, they don't make long-term assumptions, really, in the same way that we do.

We're about the only group that tries to do that.

Mr. MATSUI. In terms of the unfunded liability at this time, assuming that all current employees receive the benefit levels that currently exist, do you happen to know what your numbers might be? I know Mr. Rubin said $8.5 trillion, and I believe Dr. Aaron has said somewhere in the range of $5.5 trillion or up. Do you have a number from your actuarial report?

Mr. KELLISON. I don't have a number in front of me. It's several trillion dollars, but exactly, a specific number on a crude liability type calculation, I do not have that particular number at hand.

Mr. MATSUI. In other words, that's not anything you calculate when you do your actuarial report?

Mr. KELLISON. No, it's not.

Mr. MATSUI. OK.

I want to ask both of you these questions. My understanding is that the 75-year period that you use is not a legislative mandate; this is something you feel is appropriate in terms of your projections.

Could you just explain why that is, why 75 years, rather than 80 years or 72 years or 100 years?

Mr. KELLISON. Well, it's clearly an arbitrary number. It could be 80, could be 60, it could be 100.

But it's a number that has been used for a number of years, and we're very comfortable with it. It tends to equate to the period of time when someone entering the work force, say, in the teenage years, might live in the work force and go through an extensive period of retirement.

It's a period that's relatively compatible with that period of time. It's a period that is long enough to capture the full effect of the demographic factors like the baby boom generations so that you reach a complete state of equilibrium or maturity out there.

So, I think it's a reasonable period of time for a long-term program in terms of what is a lifetime of a person, and what is a period of time that's sufficiently long that you can really get the full dynamic effect of the demographic profile of the population.

Mr. MATSUI. Thank you.

Now, I'd like to ask both of you this question, with, perhaps, Dr. Moon, first.

Assuming that we can't come to an agreement on a 75-year fix, in 1983 I believe we thought we did, but we created the cliff, I guess. We just did it and fixed it up to 75 years, but we didn't project beyond that, and as a result of that, I guess your long-term projections required going beyond the 75 years, and all of a sudden we face this 2.09-percent deficit.

But the question I have for you is, If we could fix this for 60 years, as the President's proposal does, does it make sense at least to try to do that, and then maybe work the additional 25 years later, or is it better to wait until we have a 75-year fix?

Maybe that's a political question, but perhaps you can give me your thoughts on it.

Ms. MOON. One of the difficulties of a 75-year projection is that in a period of time like we're in today where you have in 1999, taxes that will come in that will far exceed the benefits that will be paid, and next year, that year will drop out and be replaced by a year in the 2070s in which the benefits would be higher than the revenues, then you get an effect essentially every time you move forward 1 year that puts the system naturally out of balance. That is part of what happened since 1983.

The other part is that it is very difficult to project well and predict well, what will happen, and there are changes that have been made since 1983 in our economy that people didn't anticipate.

So, I think that that helps to clarify an answer that would suggest that if you can make progress, come to consensus on changes that make sense for the system programmatically, move in a direction that people think is a valuable direction to move the program in, it seems to me you should make them as you go along, rather than necessarily packaging it as a 75-year fix.

The 75 years I view not as a requirement for any change, but rather as something that you should always keep in mind as a goal to have. If you could make substantial progress with any number of changes in the meantime, I think that that would only be for the better.

The only thing that would be a caution there is that if some of them would turn out to be in directions that people didn't think the program should go, then I wouldn't recommend that you make those changes anyway.

So——

Mr. MATSUI. I know my time is running out, Mr. Chairman.

Just as a further followup, you mentioned that obviously there are massive structural changes we can make, or we can make incremental or moderate structural changes.

You suggested that because we do have time, the funding shortfall begins in 2014 to 2015, but the real problem doesn't begin until years beyond that in terms of a cash flow problem. So, we do have some time.

If we give the current generation in the work force time to prepare for the retirement, do you feel we still have an opportunity to make moderate changes and basically keep the program as a safety net retirement program for seniors. If we didn't have Social Security, about 50 percent of seniors would live in poverty, and right now about 11.9 percent live in poverty according to your actuarial report.

Is that a correct assumption?

Ms. MOON. I would say that's certainly fair. I think that it's nice to be in a situation where the choice of whether you want to make structural changes in the program, or you want to try to retain the program as it is, although you would have to affect either benefits or taxes to do so, is a good position to be in because that allows you to make choices on the basis of good policy, rather than feeling that one set of changes is necessary or required.

Mr. KELLISON. I would like to supplement that, though, by pointing out that if you do—right now, we do have the time to look at a range of options, as Dr. Moon has suggested.

If we wait 15 years until 2014, until we hit that point at which we're in a negative cash flow position, the choices at that point are much more difficult than they are today. The solutions have to be much larger, more painful, so that even though there's not a current cash flow problem today and there won't be for 15 years, earlier action is still distinctly better.

Mr. MATSUI. I hope my question wasn't interpreted that I want to wait until 2014 or 2015. I think we should deal with it now, but I appreciate the testimony and the responses.

Thank you.

Chairman SHAW. Thank you. I particularly like your last statement, Mr. Matsui. We should deal with it right now.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I appreciate the input today, and I think we're fortunate to have you all as Trustees, and to have the actuarial information that we've been receiving from SSA that's critical to solving the OASDI problem.

Let me just get back to one thing that my friend, Mr. Matsui, said with regard to 2014 and 2034 or the 2036 time period. We've gone over this again and again in this Subcommittee and in the Full Committee, and there's a lot of debate about it.

I agree with what Mr. Matsui said at the end, which is, I think, that it's better to take the action now rather than to have the train wreck occur and being able to adjust. I think Dr. Moon and Mr. Kellison both agreed with that.

But just for the public's purposes, I think it's important to lay out here very clearly today, that both of you, although you have more optimistic projections because of the better economic conditions than we'd expected, you're extending the life of the trust fund a couple of years, you're both saying—and I think this is a direct quote from you, Dr. Moon, it's an early warning device, and there's still an urgency to make legislative changes.

I think that clearly needs to be on the record.

Second, if you could both answer this question, and, again, this has been kind of haunting this Subcommittee. What is the key date?

Mr. Matsui said there's a problem in 2014, but the real problem doesn't occur until later. What's your view of that?

Mr. Kellison, you could start, and then Dr. Moon.

Mr. KELLISON. Well, I don't know that there is one key date. There are a series of dates.

I think, to me, if I had to pick one, I guess it probably would be 2014, in the sense that that's the crossover point where now the revenue is falling short of the benefits in that year, and that's a very distinct reversal from where we are today.

Mr. PORTMAN. At that point, what would our options be? When do we have this issue of not having enough payroll taxes coming in to be able to pay out the benefits, our options would be what?

Mr. KELLISON. Well, the options at that point are that you start drawing down the trust fund interest, and then——

Mr. PORTMAN. What does that mean? For instance, for the taxpayer, does that mean more borrowing, or does it mean higher taxes, or does it mean that the government can simply absorb it?

Mr. KELLISON. Well, it basically gets back to the cash flow discussion that was discussed earlier. If the revenue coming in falls short of the payments going out, the difference will be made up out of the Treasury, whether it be interest or drawing down, or selling off the assets.

The net effect, on a cash flow basis is that the income into the system is falling short of the benefits and that has to be made up out of the rest of the budget.

Mr. PORTMAN. At this point, are there assets in the trust fund to be able to account for that cash flow problem?

Mr. KELLISON. There are government bonds, Treasury bonds, in the trust fund which earn market rates of interest, and those are real assets; they're not phony assets. But it clearly does have an

effect on the rest of the budget and on the cash flow situation in the government.

If there were no trust fund in place, what's in there would have to be held somewhere; in other words, those government bonds represent debt that somebody has to hold.

Mr. PORTMAN. How would you characterize those assets, Dr. Moon, and what do you think about——

Ms. MOON. About the dates?

Mr. PORTMAN [continuing]. About the dates. This is relevant, not just for our Subcommittee, but it is as to the public's thinking about this. We're talking about whether it's incremental change or more dramatic changes that are for many people, difficult to deal with, especially folks who have believed over the years that anything Congress does to change Social Security is going to result in hurting them one way or another, because potentially their benefits will be reduced or taxes increased.

Ms. MOON. I agree with you that there is often a misunderstanding in the public about what these issues are. What the sense of the trust fund is, I believe that beyond the 2014 date, the issue of the timeframe in which the OASDI outgo can also be paid for by interest on the debt is meaningful.

Another way to think about the issue is that the debt that is held by the U.S. Government earns interest; that interest is a promise to pay, particularly in an environment in which we may be able to reduce debt held by the public, that makes it much easier to pay the interest.

Mr. PORTMAN. Because it's easier to go out and borrow more money, which would incur additional costs because of the service of that debt.

Ms. MOON. The revenues that go into the payment of the interest is intended to be there. Now it is on the books as a payment that we make with the full faith in the same way that if I hold a Treasury bill, there is an interest payment on it.

The notion, however, is quite correct that one way or another, one has to come up with the dollars to pay the benefits and the cash flow issue is an important one and not one to set aside.

It is extremely difficult over time to imagine ways in which my generation of baby boomers can put money aside through the Federal Government in order to pay for my retirement, and I think that struggling with that is going to be a difficult issue.

I have some concerns about ways to do it as a private individual and private accounts where I think that carries some additional risks that are not inherent in a program like Social Security, but I think that those things should all be on the table for discussion.

Mr. PORTMAN. That was going to be my next two or three questions, and I've run out of time, I'm sorry. I do appreciate very much, the very informed testimony that we've gotten today.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

Dr. Moon, you have indicated previously that while the challenges we face with Social Security are important challenges, we can meet them with incremental changes rather than junking the system that America has relied on for about six decades now.

Is that your general feeling?

Ms. MOON. I believe that that is one of the options, and as a public Trustee, I think the important thing to stress is that a number of those different kinds of changes could occur.

I do think it is appropriate to point out that it would not be possible, I believe, to have Social Security continue into the future as it is now, without change.

There would have to be some changes in the program.

Mr. DOGGETT. But as far as some of the changes that have been suggested, in fact, we've had people come and sit where you are, and tell us they really don't believe in the Social Security system and would like to see it replaced entirely.

We've had the Majority Leader indicate that it was a mistake to have Social Security in the first place.

We've had one person who came and testified with a fairly comprehensive study indicating that if we were to replace the current Social Security system with an individual account system, either in whole or in part, there's not any person living on the planet today who would get any personal economic gain from that, largely due to the high transition costs of moving from the system we have now to a individualized account system.

Could you describe what some of those transition costs problems might be, and how the system would try to deal with them?

Ms. MOON. Transition costs, I think, are important. There is a very big difference between starting a system from scratch that is a funded system as people are talking about with personal accounts, versus a pay-as-you-go system, as opposed to then trying to move into that.

There are many people over the age of 50 for whom such changes are just not feasible because they have contributed to Social Security all their working lives, and to suddenly move to a system of personal accounts, obviously would not work for them.

Most reasonable proposals obviously don't do that. Instead, they would keep on the books, a basic Social Security benefit for such individuals and current retirees for a very long period of time. I'm hoping, as someone just over 50, that I'll also have a very long life expectancy, so the transition problem for me would be a 40-year transition problem, potentially, quite easily.

So, there are going to be some substantial issues that way that need to be dealt with. As a Trustee, I think the thing to stress is that one would hope we could find ways—and these are tough questions to analyze—to do them so that people could agree on what the nature of those costs are, neither to overstate nor understate what they would be.

Mr. DOGGETT. And you used age 50 as an example, but I suppose if somebody began flipping hamburgers when they were 18 and they paid into that system, Social Security earnings for 20 years, they also feel, though they haven't hit 50, that they've been paying into a system that they hope to get a Social Security check from.

Ms. MOON. Yes, I believe the transition would be much longer than 50 years. I think people talk often in the nature of 70 to 75 years.

Mr. DOGGETT. And then some of those countries that have moved to an individualized system like the United Kingdom seem to have

incurred rather substantial administrative costs. I know the low administrative costs associated with the Social Security system that has served our country so well has been one of the real points of pride of the system.

Could you describe some of the administrative costs that might come into play if we junked the system and moved to an individualized account system?

Ms. MOON. Certainly, the administrative costs are going to vary depending upon what kind of system you move to. I think one of the things, in terms of doing a study of this, is that there are better and worse ways in terms of administrative costs of thinking about that.

I believe most people who have looked at this have thought that a highly individualized, decentralized approach would have the highest administrative costs. Administrative costs could come down substantially if you restrict the number of choices or plans that people could go into, for example, and how they are overseen.

But there would be higher administrative costs than under the current system, presumably offset by higher returns.

Mr. KELLISON. I think Dr. Moon has summarized it pretty well. I think any individual account program will incur higher administrative costs than the current one.

I think that's inevitable, but there's a large range of administrative costs that would exist, depending upon the structure, and again it depends on the degree of complexity, the number of options.

If you had a very bare bones simple approach with three or four options, and there's not a lot of complexity in it, the costs would be lower than say, an IRA type model, where you sort of——

Mr. DOGGETT. Where you just go off and do your own thing, the more choice, the more costs.

Mr. KELLISON. That's correct. There's a real tradeoff between flexibility of options and cost.

Mr. DOGGETT. Some of these plans that have involved significant choice have taken almost as much as half of a worker's individual account balance, haven't they, in some other countries?

Ms. MOON. I think are a number—there are some other countries that certainly, ne would not want to use as a model in the United States, and one would hope that those lessons were learned. I don't exactly know how high they are, though.

Mr. DOGGETT. Thank you.

Chairman SHAW. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Dr. Moon, referring to Mr. Doggett's question about incremental changes to Social Security that we could make to tide us over until sometime, what are some examples of incremental changes that we could do?

Ms. MOON. There are a number of incremental changes that people have discussed. One which, for example, would be to eliminate the hiatus that's going to exist in the increase in the age of eligibility where the normal retirement age will rise to age 66, then I believe there's about an 11-year hiatus before it begins to rise again.

You could eliminate that hiatus and take care of about one-quarter or a little bit less than one-quarter of the imbalance that currently exists.

Some people have suggested raising the cap on the wages that people pay into the system on the argument that, over time, the share of wages that have been subject to payroll taxes have declined a little bit.

Another set of changes would affect the benefits and the way that the formulas work, so there are a whole range of them.

Mr. McCRERY. What do you mean by affect the benefits?

Ms. MOON. It would reduce the benefits, either at the top end of the scale is one way to do it, or across the board. All of these obviously involve some pain.

I think what you are probably getting at is the notion that incremental doesn't mean painless.

Mr. McCRERY. Incremental is a nice way of saying we are either going to raise the age of retirement, raise taxes, or reduce benefits.

That's what you just told us, and I think that's correct.

I would hope that this Subcommittee would try to be, and the Congress would try to be, a little more imaginative when it comes to solving the Social Security crisis, and I believe it is a crisis, than just raising taxes, cutting benefits, or raising the age of retirement.

Now let's talk about administrative costs of individual accounts.

Dr. Moon, do you or Mr. Kellison know what the administrative costs of the Thrift Savings Plan are for Federal employees?

Ms. MOON. I don't know. I know it's relatively low, but I don't know exactly what it is.

Mr. McCRERY. Isn't that a system of individual accounts?

Ms. MOON. Yes, it is.

Mr. McCRERY. What makes you think that administrative costs for the same type of program for individuals in Social Security would be so much higher?

Ms. MOON. I think when you compare a system, such as one that's run through a Federal employee or any employee environment, as opposed to one that's going to reach out to hundreds of millions of workers with multiple jobs and multiple accounts, potentially over time, and to turn over, the administrative costs would be higher than under the FERS system.

The FERS system, I think, is a model of how you would structure the accounts but would lower the costs.

But when you deal with individuals who have sometimes two or three part-time jobs, for example, change jobs frequently, that will also add to administrative costs over time.

Mr. McCRERY. Don't all those people who change jobs have employers who report to the IRS their income and withhold taxes and all those things?

Isn't that done already?

Isn't there already a reporting mechanism to the Federal Government for every one of those jobs?

Ms. MOON. Yes, there is. The question is, are those employers then liable in a private account system to deposit the money in the private accounts. How would that structure work?

In Social Security, my understanding is that it takes about 18 months before all those accounts are resolved in terms of figuring out where the money is going into what account and so forth.

It doesn't matter in a pay-as-you-go system; it does matter in a funded system. You'd have to do it much more rapidly I think.

Mr. MCCRERY. Well, the rapidity with which we do it is another issue. The issue we're talking about is administrative costs and I just think that in today's world of technological wizardry, that there's a way to do this without administrative costs overwhelming the advantages of a higher rate of return.

And I think it's really ridiculous for us to sit here and dismiss a rather—I almost said innovative—we've known for a long time that the power of compound interest is a pretty powerful thing, and to me it's regrettable that we've not utilized that for the Social Security system before now.

I would hope that this Subcommittee and the Congress would not dismiss trying to get a higher rate of return for at least this window that we have of a huge surplus over the next 15 years to help us out of this problem.

And speaking of that, the President has proposed setting aside 62 percent of the anticipated surplus in the General Treasury over the next 15 years for the purpose of solving the Social Security problem.

Do you know how much that amounts to, 62 percent of the surplus over the next 15 years?

Ms. MOON. I don't know.

Mr. MCCRERY. You're not really up on the President's plan? OK. It's a large amount of money.

Ms. MOON. My recollection is it's something like $2.7 trillion.

Mr. MCCRERY. Two and seven-tenths trillion dollars just over the next 15 years, and that's money—is that money over and above what we will need to pay benefits for the next 15 years?

Ms. MOON. That would be money that's over and above what would be needed to pay benefits.

Mr. MCCRERY. We have approximately $2.7 trillion sitting out there, and the Republicans have agreed to that, the President agrees to it, that we can use to finance the transition to some newer, better system.

Is that correct?

Ms. MOON. That's certainly one use of those funds. It seems to me that that's an appropriate way to put one of your sets of choices.

Mr. MCCRERY. Thank you, Mr. Chairman.

Chairman SHAW. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

I first want to thank both of our public Trustees for their public service, and I appreciate your holding this hearing on the 1999 Social Security Trustees' Report.

It's clear, in reading the report, that the trust fund is important.

And I think it's interesting that a lot of this discussion talks about the Social Security Trust Fund and the Social Security obligations in insolation.

And then we look at the total budget of the nation, and we try to reconcile our national budget system with the Social Security system.

And sometimes we want to make a point rather than taking a look at whether we're going to meet future obligations.

I agree with both of our Trustees that the trust funds are very important, and the question you asked, Mr. Chairman, as to if everything remained equal, if we didn't touch any of the money, would it make any difference on cash flow.

Well, we've never gone more than 2 years in the history of this Nation without changing our budget. The problem is that we already passed a budget. We passed it yesterday on the floor of Congress.

Everything will not be equal. The money will be spent on tax cuts or other ways, so the money won't be there.

I guess my first question to you is, If we didn't have a trust fund, if there was no trust fund today, would your annual report be different?

Mr. KELLISON. I would guess it would because if there were no trust fund, there probably would be no Trustees. [Laughter.]

Mr. CARDIN. Would the projections on the long-term solvency issues change if you didn't have a trust fund?

Mr. KELLISON. I would hope the projections that were done, the assumptions setting and the rest of that, would continue unchanged. I would certainly hope that would be the case.

Mr. CARDIN. If you didn't have the $600 billion or so that's currently in the OASDI fund, would your projections for long-term solvency issues be altered?

If all of a sudden, we said we're just going to get rid of the trust fund, and whatever surpluses happen to come out in Social Security, we're just going to put that in the Treasury of the nation and pay down on our debt, or whatever we do with it, spend it, and so forth, but we're not going to dedicate any special bonds to the Social Security Trustees because it's all one country, one system.

Would there be a difference in your analysis as to where we would be?

Mr. KELLISON. There would not be a difference in the actuarial analysis in terms of making these assumptions on economic and demographic factors and what that results in.

Mr. CARDIN. Where would we be in your projections in the year 2000 and let's say 2015, if we didn't have a trust fund?

Mr. KELLISON. In the year 2015, if there were no trust fund, you essentially would be in a negative cash flow position at that point because you——

Mr. CARDIN. Where would you get the money to pay for that?

Mr. KELLISON. It has to come out of the rest of the budget.

Mr. CARDIN. Legally, how would that happen?

Mr. KELLISON. I am not a lawyer. Clearly, at this point in time, the only resources available to pay Social Security benefits have to come out of the trust fund. Clearly, that kind of a law would have to change.

Mr. CARDIN. Congress would have to take action in order to make sure that Social Security checks continued?

Mr. KELLISON. Absolutely.

Mr. CARDIN. In the full amount.

If we continued the trust fund, would Congress have to take specific action?

Ms. MOON. My understanding is no. If we continue the trust fund,certainly there's the period in which the interest would continue to keep the balance in terms of payments and the revenues into the system. And after that, we would be drawing down the debt that is dedicated for this purpose.

My understanding is that this is a commitment and an obligation that is a strong indication that we believe this is important enough to continue it in that vein.

I also think there's the issue of, if you were to eliminate the trust funds, I think that there would be a very strong incentive to substantially reduce the taxes that are now going to fund both Social Security and other things that we are now seeing in terms of the buildup of the trust fund.

Mr. CARDIN. It would be difficult to continue public support for overpaying for current benefits is what you're suggesting.

One last question because my time is running out.

You're Trustees, and if you were charged with providing for 75-year solvency, and if there were no restrictions on how you could invest the moneys, and if you were looking to ensure a 75-year system with the modifications that we would be making this year, would you continue an investment strategy that would buy U.S. Government bonds, or would you look at a different way of dealing with the return you have on your trust assets?

Mr. KELLISON. That's not an option that we have had. Current law requires all of the money——

Mr. CARDIN. I said if we didn't have that. You're a Trustee——

Mr. KELLISON. We're Trustees. I think we would, as fiduciary responsibility as a Trustee, we would clearly have to look at the appropriateness of that investment policy very hard.

And it could conceivably change if that were a flexibility that we had.

Mr. CARDIN. Dr. Moon, you're an economist. How would you see that as a Trustee?

Ms. MOON. My belief is that one would want to look both at what was possible to responsibly invest in elsewhere, but I think some considerable amount of conservativeness is appropriate.

Social Security is the absolute base of retirement for individuals, it's not where I think you'd try to maximize returns, either individually or publicly.

I think what you want to do, if you thought there were things you could do for which there were protections, the appropriate protections, you might consider it, but I think you should err on the side of investment conservativeness in this program.

Mr. CARDIN. Thank you.

Thank you, Mr. Chairman.

Chairman SHAW. Just a couple of observations.

I know Mr. Cardin wasn't implying this, but I want to be very clear, particularly in facing the Trustees here.

I don't know of anyone who is talking about, in any way, diminishing or doing away with the trust fund.

I want to be very clear as to your futures if you are reappointed. [Laughter.]

Mr. CARDIN. If the Chair would just yield very briefly, there are proposals, though, that would increase the trust fund, and I think the Chair was inferring that that wouldn't have any impact on the overall budget of our Nation or overall cash flow issue.

Chairman SHAW. That was the point I was trying to make.

Mr. CARDIN. The point I was raising is that if you go to zero, the point that you're making that by increasing it, it has no effect, then I would suggest that by decreasing it, by the same analogy, it would have no effect. Therefore, if it makes no sense to double the fund, then why don't we just get rid of it?

Obviously, I'm not suggesting we get rid of it.

Chairman SHAW. And neither am I.

I'd also like to comment with regard to what would happen if we do do nothing and the trust fund, FICA taxes coming into the trust fund, are not sufficient to pay its obligations, as has been stated, it won't be in 2014, it won't be relying upon interest paid on the bonds to take it to 2022.

And then the appropriate process will have to come in, unless this Subcommittee was willing to increase FICA taxes.

We would be leaving a terrible, terrible burden to future Congresses or a terrible disservice to future generations relying upon Social Security.

And I think that's a tremendously important point.

Mr. Hayworth.

Mr. HAYWORTH. Thank you, Mr. Chairman, Dr. Moon, Mr. Kellison.

Dr. Moon, I appreciate it when you use the word "conservative" in any context, and I thank you for that.

My good friend from Maryland, and my esteemed Chairman, just had an exchange that I think is illustrative of part of the problem.

There was once a wise man who said, Isn't it a shame that youth must always be wasted on the young.

We could amend that perhaps this morning to say, Isn't it a shame that sound policy must always be predicated on electoral politics, not the notion that the people decide, but some of the trappings that go along with it.

I'm so sorry my good friend from Texas schedule would not allow him to stay, because I feel compelled in the record just to ask you both—and it may be in terms of what you perceive, both as Trustees of our Social Security funds—do you know of any scheme on the part of any political party, especially the two parties that inhabit the U.S. House of Representatives, to destroy Social Security?

Mr. KELLISON. I personally know of none that are serious. There are fringe groups that might take that position, but I know of none that are serious.

Ms. MOON. I think there have been proposals that have been made by people that would largely dismantle some of the protections of Social Security, but my belief is that even relatively major restructuring proposals usually try to retain a number of the elements that I think are very important in the Social Security system.

Mr. HAYWORTH. And the record should reflect and perhaps you can feel free to correct me, since my friend from Texas mentioned the Majority Leader specifically, and I think it's important to have it in the record, you know of no plan from the Majority Leader to dismantle or destroy Social Security?

Ms. MOON. Not that he's communicated to me anyway, no.

Mr. HAYWORTH. Thank you.

I'm sorry we had to do that, but again it points up some of the difficulties we face because there are those who succumb to a temptation to replace facts with fear and perhaps it's just the legal background that they have. They feel they have to plant a sufficient doubt in the minds of the jury when it comes to making decisions.

I appreciate the comments of my good friend from Louisiana about administrative costs.

Would you agree with me that administrative costs are not static? In other words, they do not occur in a vacuum. There are changes that can occur in the current system that could lead to reduction of administrative costs, are there not?

Ms. MOON. Certainly.

Mr. HAYWORTH. For example, one of those, because we had some interesting testimony from a man whose government job is that of a Social Security claims representative, but who has not actually handled a claim since 1983, he instead spends his time as basically a shop steward of a union to make sure that union conditions are maintained for the betterment of the union.

Indeed, he was dispatched to Oklahoma City in the wake of that horrible tragedy, not to deal with Social Security claims but instead to represent the interests of the union, and he does so on the taxpayers' dime.

Do you think that's a wise use of administrative funds in Social Security?

Ms. MOON. You can answer that one. [Laughter.]

I think we're getting into areas of policy that are probably beyond both our expertise. [Laughter.]

Mr. HAYWORTH. But Dr. Moon, certainly with your intelligence and your ability to observe the scene, do you think there could be some readjustments, that perhaps people who have job titles in administering what has become a sacred trust for the American people, that should actually spend time on fulfilling what their job descriptions say they do?

Ms. MOON. I believe collective bargaining is a well-established and valued part of our history.

Mr. HAYWORTH. Certainly. That's not my question.

Ms. MOON. And I think those same protections need to be available to workers in the Federal Government. Sometimes that means some higher costs. And I assume that's a negotiated agreement and that's part of it.

Mr. HAYWORTH. I appreciate that, Dr. Moon.

That's not the nature of my question.

It was simply, could we reduce costs if those who have a job title saying they are claims representatives in fact carried out that job rather than constantly spending their time in the collective bargaining process?

We can agree that collective bargaining plays an important role in the labor force. I think we would all agree with that.

Let me go to another question before my time is up.

Chairman Greenspan came to testify to us, and we appreciated the President's remarks thinking outside the box about the future of Social Security.

But the President talked about government direct investment in the stock market. Indeed, the Senate voted in 1999 to nothing in opposition to such investments.

What are your thoughts about the government investing directly in stocks, as our President has proposed?

Mr. KELLISON. I think that's a topic we would have to face as Trustees if the restrictions on investments in Treasury securities were removed.

At that point, we would have to look at a broader range of investment options.

I think there are a number of issues that have to be dealt with very carefully there.

When I was a schoolboy, we used to call government ownership of private industry socialism. That's a term that we don't use much anymore in quite that way.

But I think if Federal funds were to be invested directly into equities, there would have to be a number of questions answered along those lines that really are policy questions, as well as rate-of-return questions.

I think Chairman Greenspan was basically trying to draw attention to the fact that there are a number of issues of that kind, corporate governance issues, who owns industry, and so forth, that we can't ignore if we get into that realm.

Ms. MOON. And although it might be tempting, as a public Trustee, to own America On Line personally and control it, I think you would want to have a lot of protecticns in place.

My responsibility as a public Trustee would say I would want to have a lot of protections where I felt that the gains that you might get from higher returns were not only worth it in terms of the kinds of restrictions that would need to be placed on such a system, but also there would need to be a lot of protections put in place to keep it out of the political system and environment.

I think there are a lot of questions.

As public Trustees, I don't think we believe it's our role to say this is a good idea or a bad idea, but rather to caution there are a lot of things you'd want to put in place before you did that.

Mr. HAYWORTH. I see my time is up.

Again, Dr. Moon, Mr. Kellison, I thank you for your testimony.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

There are several groups in the Congress that are working on this particular issue, and I happen to be on a task force with another Committee, the Budget Committee, that's trying to find some answers to the Social Security problem.

Yesterday, we met with a number of actuaries, two from the Social Security system, the administration, as well as two outsiders.

They all had a lot of facts and figures about how we are extending the life expectancy, and how the new gadgets are making people physically able to work longer, and they differed on some of the numbers.

But one thing they didn't differ on is the fact that as time goes on, there will be a lower or a closer ratio of workers to beneficiaries. Today, it's about 3.3.

I believe by the time the report ends, it's 1.8 or almost 2 to 1. There was no dispute over that.

Mr. Greenspan's been mentioned.

Mr. Greenspan testified that unless you end the current pay-as-you-go type system, where the current beneficiary or the current workers pay the benefits, at some point in time, you'll have the same problem reoccur again.

The question is, Do you end the current pay-as-you-go system, or the current Social Insurance Program.

If so, who do you end it for, what age group or what age groups?

And that question hasn't been answered.

There is no immediate crisis. We know there's a problem coming, the train, you can listen to the rumble and the roar, and you'll hear it, but it's not immediate.

That's the reason currently it's seniors who are under the Social Security system, the drawing of benefits, it's the reason they don't trust Congress to deal with this, especially if it affects them.

In fact, Members of Congress don't even trust Members of Congress to deal with this because of the political volatility of it.

Any plan that comes up that changes the benefit structure of the current recipients of Social Security or those who are just about to go into it, raises red flags to the point it makes it difficult, probably makes it impossible for us to do anything in this Congress that will be substantial or will be beneficial, far different from the way Medicare was.

We dealt with Medicare in 1995 and then again in 1997. That was a crisis. It was in a deficit cash flow. And I go home and I talk about Social Security at every meeting that I have, every group I talk to. I'm not afraid of it as the third rail of politics, it's real.

It's my old age pension as well as yours. But people at home say, If you hadn't have robbed the trust fund, and spent it, we wouldn't have a problem.

They haven't been convinced yet that there is a problem coming, and I'm glad to see that both the administration and the Congress are taking steps to try to stem that concept at home.

The President said we're going to set aside 100 percent last year, and changed a little bit on percentages for this year.

But the Congress just passed a budget yesterday that does set aside FICA taxes, plus the interest that's owed on the notes that are held by the trust fund.

We're making some headway, but it's slow, and I think it needs to be slow.

My daddy had only a third-grade education. In fact, he didn't even finish the third grade. And when I was a young guy, I thought I was a lot smarter than he was. But as I got a little bit older, I found out that he was a whole lot smarter than I was and I am.

But he used to tell me, when I wanted to get in a hurry to do something, Son, haste makes waste.

We thank you for coming today, we thank you for your report, and I look forward to reading through your report.

Thank you.

Chairman SHAW. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

I was afraid if we didn't ask a second round of questions, this would be the shortest hearing we'd ever had before the Subcommittee, so I wanted to take advantage of these two prominent experts in the field to just ask a couple of more questions.

Over the past 75 years, the economy has grown, on average, 3 to 3.5 percent per year. Yet your projections, the Trustees' projections about future economic growth are about 1.5 percent per year.

Why are the growth assumptions so much lower for the future than the facts show about the past?

Mr. KELLISON. That's a complex question, but I'll try to give you some answer, and Dr. Moon may have a little different way to express it.

It largely is a result of labor force participation, and essentially labor force participation rates have increased fairly significantly over time.

That inevitably comes to an end because of the baby boom generation moving toward retirement, and the percentage over time of, say, working women in the work force has increased significantly, but at some point hits a plateau.

In terms of just the age distribution of the population, and the percentage of both genders for that matter that are already in the work force, entry into the work force has to slow down significantly in the next 25 years, compared to, say, what it has been in the last 25 years.

I think, in a nutshell, that a large part of the explanation has to do with just what the potential work force is.

Ms. MOON. It's interesting you asked that question because when Steve and I first came on board as public Trustees, we were actually criticized sometimes for being too optimistic about the future.

And now the criticism tends to be that we are too pessimistic.

Maybe we're honing in on getting it right.

But I think our sense has been that the economic assumptions, while we would like them to be higher, and we would hope that that's what happens, we think that since this trust fund report is supposed to provide some warning about potential problems ahead that we should try to err on the conservative side, that we should try to keep the growth rates a little lower than some people have thought they might be.

The other thing is you have to be very sober in looking at something 75 years ahead. One of the things the actuaries do for us every year, when we start to talk about the assumptions, is provide us with a wealth of information about what has happened in the last 5 years, 10 years, 20 years, 50 years, 75 years, and it is an enormous task to try to think about what the long run really does look like.

Mr. MCCRERY. In other words, the Trustees don't see much hope of growing our way out of the problem?

Ms. MOON. I think the last couple of years indicate that certainly economic growth can play a part in helping to reduce the size of the problem. And one would certainly like to encourage everything that's possible, as people have talked about, to encourage savings and higher productivity. That will certainly help.

Because whatever we do about Social Security, we will have an aging population into the future that's going to change enormous numbers of things about our society in all sorts of ways.

But I think we don't want to count on it, and we don't want to base this report counting on such change.

Mr. MCCRERY. The Social Security Advisory Council included in its report some data that most of us are familiar with.

One being that over the last 75 years or so, stocks have earned an inflation adjusted return of about 7 percent annually, whereas Treasury bills or bonds have averaged about 3 percent or a little less than 3 percent annually.

In light of your expectations for lower economic growth over the next 75 years, is there any reason to expect that those returns will differ, vis-a-vis stocks and Treasury bonds?

Mr. KELLISON. I'm not an economist so I'll defer to people that are to perhaps give you a more solid answer to that question. I think that is a valid question.

In other words, if the future growth rate in the economy does decline, say, from three-something to one-something, can the stock market continue to deliver 7-percent returns over a long period of time is certainly a question that needs to be asked.

On the surface of it, it does appear to be difficult to achieve, and again I would predicate my answer by saying I'm not an economist but I think that's a valid question that will really have to be looked at.

Mr. MCCRERY. Dr. Moon.

Ms. MOON. I concur with Steve Kellison, that this is something that's very difficult to know. There ought to be a link. One would think that there would be a strong linkage between the health of the economy and the health of the stock market, but I've been around long enough to observe that there doesn't always seem to be a very close correlation, and I know a number of my economics colleagues who have also found that out through bitter experience over the years.

But I do think that that is one of the things, when someone wants to make the comparisons, that you have to try to be very careful to be as realistic as possible in those comparisons.

You would want to try to have a consistent set of assumptions between what you're using to compare the current system as it is now and one that involved private accounts in which there would be these kinds of investments to be able to make the best possible comparisons about the pros and cons of those different approaches.

Mr. MCCRERY. Just one quick addition.

Even if the rates of return for stocks are lower because of lower economic growth, would rates of return on Treasury bonds also be lower because of low economic growth?

And could we or should we expect still a premium on the return of stocks over Treasury bonds, even with lower economic growth?

Ms. MOON. On average, one would expect that the returns would be higher from stocks over time, again because of the risk differential. That's really what they're reflecting in part. That is the big driver in terms of that differential.

Mr. MCCRERY. Thank you, Mr. Chairman.

Chairman SHAW. Thank you.

If there are no further questions, we will conclude this hearing.

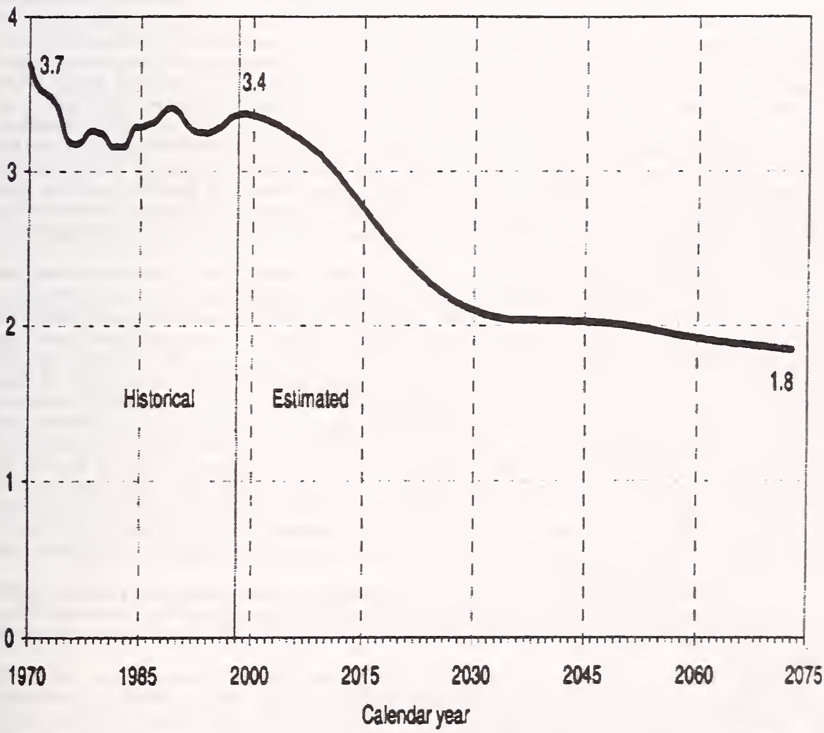
Steve, Marilyn, we'd like to thank you for the job that you do, the work you do for all of us, and for your time here today.

Without objection, I would ask that the graph contained in the status of the Social Security and Medicare Programs be inserted in the record.

This is a graph that shows the diminishing number of workers to support the number of retirees that's contained in the Trustee's Report.

[The information follows:]

Chart D-Number of Workers per OASDI Beneficiary



Chairman SHAW. Thank you very much.

The hearing is concluded.

[Whereupon, at 11:35 a.m., Thursday, April 15, 1999, the hearing was adjourned.]

[A submission for the record follows:]

Testimony of Michael A. Steinberg, Esquire, Michael Steinberg & Associates, Tampa, Florida

I appreciate the opportunity to submit a written statement for the printed record of this hearing and your consideration of the same. My name is Michael Steinberg, and I am the principal attorney in the law firm of Michael Steinberg and Associates. Michael Steinberg and Associates is a moderate-sized law firm with offices in Worcester, Massachusetts; Washington, D.C.; Jacksonville, Florida; Ft. Lauderdale, Florida; Tampa, Florida; and Clearwater, Florida. Our firm primarily handles Social Security related matters and is made up of attorneys with both strong Democrat and Republican affiliations. This statement, however, is not submitted on behalf of any client, firm, or organization, but is simply a personal analysis and critique of the 1999 Annual Report of the Board of Trustees on the financial status of the Federal Old-Aged and Survivor's Insurance (OASI) and the Federal Disability Insurance (DI) Trust Funds.

It is my understanding that despite the report's projections regarding OASDI are slightly improved from those reported in 1998, the spending is still projected to exceed tax income in the year 2014 and trust funds will be depleted by 2034.

As in prior years, the Trustees recommend that action be taken to reform the Social Security program. "It is important to address the financing of both the OASI and DI programs soon, to allow time for phasing in any necessary changes and for workers to adjust their retirement plans to take account of those changes"

We all are familiar with the traditional choices to reform the Social Security program, but for the purpose of analysis, I will enumerate the same below:

1. *Establish individual accounts without reducing benefits for those approaching retirement age:* Those in favor of allowing individuals to set up personal savings accounts suggest that benefits to be paid to current retirees and those soon to retire be maintained by the Social Security surplus while future Social Security recipients' benefits be reduced. They argue that the increased revenues from the personal savings accounts will exceed the expected rate of return on Social Security Trust Fund monies, thereby netting the future retirees with the same or more retirement income. Opponents of this type of plan counter that by 2010–2014, the plan would require new taxes, deeper cuts in the rest of government, or deficit spending, and that individual accounts are essentially a large new entitlement program. For instance, Wendell Primus of the Center on Budget and Policy Priorities, posits that this plan would sacrifice the needs of younger generations to increase benefits directed to the elderly, especially the more affluent elderly, and weaken the progressive nature of the current benefit structure.

2. *Cutting benefits:* A. The retirement age for full benefits is currently scheduled to increase to 67 over the next 20 years. There are suggestions that the retirement age be raised to 70. Opponents argue that this would be unduly burdensome on many "blue collar" workers who will not be able to physically sustain work until age 70. Proponents say that it is the poor and middle class that will actually benefit from raising the retirement age. If someone is physically unable to engage in substantial, gainful activity, he or she qualifies for Social Security Disability Insurance Benefits, which pays benefits at substantially the same rate as if he or she retired at "full benefit retirement" age. Blue collar workers are more likely to qualify for Disability Insurance benefits than white collar workers. Presently, many middle income workers cannot make ends meet if they retire at age 65. It is the wealthy that can afford to retire earlier. Furthermore, as the country's economy shifts from agriculture and industry to service and technology, people will be able to physically work longer. There is no reason why a lawyer, accountant, judge, or Congressman should not be expected to work until age 70.

B. Cost-of-living adjustment: There is a growing consensus that the current method of calculating the cost-of-living adjustment (COLA) based on the Consumer Price Index (CPI) overstates inflation and that some change in the COLA formula needs to be made.

C. Reduction in benefits for the middle-class and upper-middle class: For some time there has been discussion about reducing benefits to retirees with higher average monthly earnings and/or retirees with high retirement income from other sources. Opponents argue that the wealthier participants paid money in the system, it is "their money," and they are entitled to a fair return on their "investment," regardless of whether they "need" the income as much as their poorer counterparts.

Proponents point out that the Social Security Retirement system is a noncontractual welfare benefits program and thatSocial Security recipients' benefits are not dependent on the amount they have put into the system by taxation. Furthermore, although Social Security is an earned benefit program, Congress has wide latitude to create classifications for the allocation of benefits.

D. Increase the cap on taxable earnings: A viable, partial solution to bolster the Trust Fund is to accelerate the increase of the cap on taxable earnings. Since Social Security is a progressive tax, the higher the average earnings of a participant, the lower the percentage rate of his return. However, once the participant reaches his cap on taxable income, he can theoretically invest the same percentage of his earnings in his IRA or 401K plan, netting a higher rate of return than his lower income cohort. Raising the cap on taxable earnings would raise the participant's expected return on contributions, but at a lower percentage rate of return. An advantage to this type of proposal is that the cap on taxable earnings can be periodically adjusted without a drastic overhaul of the Social Security system.

E. Invest Trust Funds in securities: At present, Trust Fund surpluses are "invested" in Treasury securities, earning a relatively low rate of interest. Many suggest that we invest part of that money in securities in private securities. Initially, one might conclude that since historically the stock market has realized higher rates of return than Treasury securities, the Trust Fund would grow more rapidly, easing the solvency problems.

There are several problems with this solution. First, if the United States Treasury did not have the ability to borrow Social Security Trust Funds at a low rate of interest, it would have to borrow elsewhere at a higher interest rate. This would in turn exacerbate the deficit problem and/or result in decreased spending on other programs. At the same time, a greatly increased supply of capital to the stock market may not have beneficial results and might result in smaller rates of return on investments. Furthermore, opponents are wary of giving so much control over the stock market to the government.

F. Reduce disability rolls: According to Social Security data, as of January 1999, 44,168,500 received Social Security benefits of which 27,473,000 were retired workers, and 4,763,900 were nondisabled widows and widowers.

There were 5,617,700 beneficiaries receiving payments on the basis of disability. 4,710,700 disabled workers, 712,700 disabled adult children, and 194,300 disabled widows and widowers. In addition, 185,500 spouses, and 1,398,400 minor and student children of disabled workers were receiving benefits. Monthly retirement benefits totalled $31.3 billion and $3.8 billion to disabled workers.

The average monthly benefits as of January 1999 were $780 for retired workers and $733 for disabled workers. Having been practicing law for 17 years, most of them in the area of Social Security Disability law, I have had the opportunity to represent literally thousands of Social Security Disability recipients and discussed the economics of the Social Security Disability program with Administrative Law Judges, claims representatives, state disability determiners, claimants, and other attorneys (both private and government). Recently, there have been hearings and discussions about efforts to assist disabled beneficiaries in returning to work. One proposal was to raise the amount Social Security would deem substantial gainful activity. Another way is to extend health care coverage to persons removed from the disability rolls. The above proposals are faulty both theoretically and in practice.

Proponents of raising the substantial gainful activity level to $700 suggests that if a person is on disability and the SGA amount is $500, a person will not even try to return to work for fear of losing benefits, but if the SGA amount is $700, that person will get a job making less than $700 per month until he or she can regain skills and eventually get off the disability rolls. The other theory is that disabled workers will not get off the disability rolls for fear of losing health care coverage. Both of these theories are irrational and illogical.

First, Social Security already gives disabled recipients a trial work period of 9 months (earnings during trial work periods do not affect payment of benefits). Secondly, health care is readily available to the poor and lower income families who do not qualify for Medicare, i.e., county health care, VA, state welfare, etc.

Instead, legislation needs to address a disincentive to beneficiaries receiving Disability Insurance benefits, for not making an attempt to return to work. A rational proposal would be to require disabled workers to perform community service as a condition requisite to receiving benefits. (Exceptions could be made for persons with extreme disabilities.) By requiring this, recipients would be persuaded to return to work and learn job skills and trades, while doing "volunteer" work. In addition, the general public would benefit from the services performed and recipients would receive a boost in self esteem. There are already nonprofit organizations such as the United Way, Salvation Army, etc., that have the capability of monitoring participation in such a program.

G. Increase the cap on how much a retiree may earn before a reduction in retirement benefits and/or eliminate reduction in benefits altogether: Many Social Security retirees do not see the logic in reducing their retirement benefits, if they choose to continue to work after retirement age. After all, if they paid money into the sys-

tem, aren't they entitled to a return after reaching a certain age? Reducing benefits to retirees who earn over a certain amount, does not increase revenues or decrease expenditures. It merely discourages the elderly from working, thereby actually reducing the potential contributions to the system far greater than any savings in expenditures.

Those against the change say that since Social Security system is not a retirement program, but a social welfare benefit designed to replace a worker's lost earnings, allowing retirees to receive their full retirement benefit and earn an unlimited amount of money would be contrary to the intent and purpose of the program.

Conclusion

Drastic changes should not be made to the Social Security retirement and disability programs. Small changes should be made in several areas rather than large changes in any one area. The changes that are made should be ones than can be "undone" or modified without an inordinate cost, i.e., decreased COLA, increasing income cap, etc., versus setting up private savings accounts, investing Trust Funds in stock market, etc. Efforts should be made to decrease the disability rolls by mandating community service by recipients of Disability Insurance Benefits.

It is important to bear in mind that the economics of Social Security cannot be studied in a vacuum. There are many factors that effect the integrity of the program which occur outside of the program.

Ironically, it appears that the traditionally conservative party is more apt to support "changes" in the Social Security system, while the "liberal" party is more "conservative."

Thank you for your consideration of the above.

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